Fair Political Practices Commission
MEMORANDUM

To: Chairman Getman, Commissioners Downey, Knox, and Swanson

From: Lawrence T. Woodlock, Senior Commission Counsel Luisa Menchaca, General Counsel

Subject: Proposition 34, Repeal and Permanent Adoption of Amendments to Emergency Regulation 18428

Date: March 29, 2002

Introduction

In December, the Commission updated regulation 18428, which treats the reporting obligations of "affiliated entities," by adopting an amended version as an emergency regulation. The amendments (Attachment "A") amounted to a limited "technical cleanup" that removed language added to accommodate changes in the law introduced by Proposition 208, which were then repealed by Proposition 34.

Since December, no case has been presented for further modification of these "technical" amendments, and no one suggests that the emergency regulation be permitted to lapse. However, there have been some requests that the balance of the regulation be revised to make the filing requirements more clear. Clarifying modifications of the emergency regulation are included within the scope of the notice, if the Commission is inclined to act now on recent suggestions. More substantive changes should not be made at present, and staff recommends that, if more extensive work is desired, the Commission calendar a more substantive review later in the year, after further study of the concerns recently voiced by the regulated community. The emergency regulation will expire by operation of law on April 25, and staff recommends that the Commission permanently adopt the emergency regulation, with or without "clarifying" modifications.

A. Background

At its monthly meeting in October, 2001, the Commission considered whether to adopt a regulation implementing § 85311, added to the Act by Proposition 34 to govern the aggregation of contributions by "affiliated entities." The Commission decided that a regulation was not necessary to explain or implement the new statute, the language of which had been adopted by the Commission as its own "affiliated entities" regulation in 1995. But in its memorandum to the Commission on this subject, staff recommended conforming amendments to regulation 18428, which establishes the reporting obligations of "affiliated entities." This regulation was amended in 1997 to reflect an expanded definition of "affiliated entities" introduced by Proposition 208, now repealed by Proposition 34. As a result of the 1997 amendments, regulation 18428 contained provisions not supported by the law in

effect after passage of Proposition 34.

1. The December Amendments to Subdivisions (a) and (b)

The Commission agreed at its December meeting that it should consider amendments to bring regulation 18428 into agreement with the newly amended § 85311, as proposed by staff. The Commission went on to adopt an amended version of regulation 18428 as an emergency regulation. The amendments adopted in December modify the first two subdivisions of regulation 18428, as illustrated in Attachment "A."

Prior to the emergency regulation, subdivision (a) contained a reference to regulation 18531.1. That regulation implemented the aggregation provisions of Proposition 208, and had already been repealed. The citation to that regulation was therefore deleted. It was replaced by a reference to § 85311, which governs contributions of "affiliated entities," as well as reference to 2 Cal. Code Regs. § 18225.4, which provides for aggregation of their independent expenditures. By amending regulation 18428(a) in this fashion, the Commission made it clear that the scope of this reporting regulation is limited to entities that are affiliated by their decisions to make contri-butions or independent expenditures, thereby affecting California campaigns, but not for reasons of ownership, structure or "control" in areas not regulated by the Act.

Subdivision (b) imposed a reporting obligation couched partly in the language of the Proposition 208 version of § 85311. Prior to Proposition 208, when one entity "directed and controlled" the contribution decisions of another, they were classified as "affiliated entities." As amended by Proposition 208, § 85311 spread a much wider net, providing as follows:

> "All payments made by a person established, financed, maintained, or controlled by any business entity, labor organization, association, political party, or any other person or group of such persons shall be considered to be made by a single person."

Proposition 34 replaced that statute with the current version of § 85311, which restores the previous understanding of "affiliated entities," limited to persons related by a common direction and control over contribution decisions.

In December, the Commission deleted the four words in regulation 18428(b) that reflected affiliation criteria added to the Act by Proposition 208, which are inconsistent with the current statute. The language remaining after deletion of these four words more closely tracked the current wording of § 85311 and regulation 18225.

To *precisely* reflect the current statutory language, the Commission decided to insert the words "directs and" before "controls" in the fourth line of subdivision (b), to indicate that the standard of "affiliation" for reporting purposes is the same as the standard used for aggregating contributions in § 85311, and independent expenditures in regulation 18225.4. The Commission also inserted the words "expenditures of the" following the word "controls" to bring the regulation fully into line with *Lumsdon* and *Kahn*,[1] the Commission's 1976 opinions which established the understanding of "affiliated entities" that underlies the current version of § 85311.

2. Deletion of Subdivision (c)

While portions of subdivisions (a) and (b) were amended in 1997 to bring the regulation into conformity with the new aggregation rules of Proposition 208, the *entirety* of subdivision (c) (as then numbered) was drafted at the same time, for the same purpose. Under former regulation 18531.1(b), construing the broader "affiliation" standard of Proposition 208, "all contributions made by affiliated entities shall be considered to be made by a single person." Subdivision (c) was added to regulation 18428 to require disclosure of contribution activities by all of the filer's affiliated entities, as broadly defined by Proposition 208.

Under current law, contributions must be aggregated only when "directed and controlled" by a person other than the ostensible payor. With the loss of Proposition 208, there was no longer any statutory authority for requiring disclosure of "any" or "all" contributions of affiliated entities, if they do not meet the narrow criteria for aggregation under the new § 85311.

B. Recent Suggestions for Further Amendment

Shortly after the agenda packet was mailed on March 4, two interested persons contacted staff to discuss at some length what they regarded as unclarity in the filing requirements stated in regulation 18428. The first such comments came in by telephone from attorney Vigo Nielsen. His comments were directed at the language of subdivision (d), noting that the two sentences making up this subdivision could be read as imposing inconsistent requirements. The first sentence directs the recipient of a contribution to "list the name of the contributor and its affiliated entities," which seems to require a list of the names of the affiliated entities. The second sentence clearly does not require that the names of the affiliated entities be listed.

To eliminate this potential for confusion, staff proposes that a portion of the first sentence be rewritten, as shown on lines 18-19 of Attachment "D." The revised wording would specify that the recipient of a contribution from an affiliated entity need only identify the contributor as an affiliated entity, but is *not* required to reproduce all of the detailed information furnished by the contributor. This change

[1] *In re Lumsdon* (1976), 2 FPPC Ops. 140; *In re Kahn* (1976), 2 FPPC Ops. 151.

would make it clear that the first sentence of this subdivision requires no more detailed reporting than that which is specified in the second sentence.

Nielsen also proposed that the term "affiliated entity" be defined in the regulation. This term has long been in use to describe members of a group related by a common direction and control over the contribution decisions of group members. It is possible to describe at least three functionally distinct members of such a group. There will always be an ostensible donor, whose contribution decisions are "directed and controlled" by a second person. If the latter person directs and controls the contribution decisions of more than one other person, those other persons are also "affiliated" with the one who controls the contribution decisions *and* with all others whose decisions are controlled by the same person. (See § 85311(b).) Staff agrees that such a definition might be useful, but believes that the problem identified by Nielsen can be remedied without that further step.

Nielsen recognized that the Commission's purpose in the emergency amendment of regulation 18428 was to remove references to the Proposition 208 version of § 85311, substituting language consistent with the current statute. Subdivision (d) is not based on the Proposition 208 version of § 85311, and so it was not amended as part of the "Proposition 34" project. Nielsen believes that the amendments introduced by the emergency regulation are necessary and should be adopted, although he also urges clarification of subdivision (d).

In a letter dated March 5 (Attachment "B"), Cal-LEAP voiced different concerns. Cal-LEAP also does not quarrel with technical amendments expunging outdated references, but it wants clarifying and more substantive amendments as well. Cal-LEAP begins by directing attention to perceived ambiguities in regulation 18428(b). This subdivision applies to "independent expenditure" and "major donor" committees, but does *not* apply to "recipient committees." (§ 82013 (a),(b), and (c), respectively.) Regulation 18428(c) applies to recipient committees. A brief overview of these two provisions will supply useful background to Cal-LEAP's comments. (See also Chart, Attachment "C.")

Regulation 18428(b) requires that a joint campaign statement be filed by persons which qualify as independent expenditure or major donor committees, and which are "affiliated entities" because one person directs and controls their contribution decisions. The joint statement is filed in the name of the person exercising this control, and must indicate that the statement includes the activities of the affiliated entities. The statement must also show which entity made each payment itemized on the report. The last sentence of the regulation provides that the person filing the report must update the roster of affiliates on each successive statement. This jointly filed statement makes it easier for the public to identify major donors and independent expenditure groups acting together under common direction and control.

Subdivision (c) of regulation 18428 specifies that, unlike the committees governed by subdivision (b), every recipient committee must file a separate campaign statement. Recipient

committees have more extensive filing obligations than independent expenditure or major donor committees, and joint statements including recipient committees may quickly become too complex to interpret readily. The Commission should note, however, that the current Form 460, on which recipient committees file their campaign statements, does *not* require identification of entities with which recipient committees are affiliated. In addition, the current regulation does not provide for reporting in situations where a recipient committee becomes affiliated with a major donor or independent expenditure committee. Staff recommends that it review this regulation in its entirety and return to the Committion later this year with fully considered suggestions for improving the reporting obligations of affiliated entities.

For now, however, Cal-LEAP believes that the requirements of subdivisions (b) and (c), outlined above, are not clearly expressed by the current wording of these provisions. This can be cured with a few clarifying modifications, as set out in Attachment "D."

The first sentence of subdivision (b) is clear enough in its application to entities which do not receive campaign contributions (i.e. are not "recipient" committees as defined at § 82013(a).) But revisions to subdivision (c) (Attachment "D" at lines 14-15) would make it more clear that recipient committees are governed by subdivision (c), and not by subdivision (b). Substitution of the word "filer" for "committee" (Attachment "D" line 10), and the addition of a restrictive clause (at lines 11-12) offer the filer still more specific guidance. Staff believes that these clarifying changes will suffice to clear up any lingering uncertainty as to what is required by these two subdivisions.

Cal-LEAP's concern that subdivision (e) was ambiguous as to the nature of the records to be kept may be resolved by removing the ambiguous reference to "a list of affiliated entities," leaving only a reference to "the notice required by this section." (Attachment "D," lines 22-23.) Thus it would be clear that it is the contributors' notices that must be kept, and nothing more. (See also regulation 18401(a)(2)(B).)

Cal-LEAP requested that the regulation specifically provide that subdivisions (d) and (e) not be applied to contributions between affiliated entities, or between a sponsor and sponsored committees. Staff does not believe that it is "unduly burdensome" or "exalts form over substance" to require notification and disclosure when contributions are made among affiliated entities, since the affiliated entities may not in many cases be able to comply with their own reporting obligations without such information. For example, person "A" directs and controls the contribution decisions of two separate entities, "B" and "C." If "B" contributes to the PAC operated by "C," the PAC might not realize that "B" is an affiliated entity of "A" and "C," and would not describe the contribution as originating in an "affiliated entity" unless "B" is subject to subdivisions (d) and (e).

The lack of information on affiliated entities among members of complex associations would not be a problem between sponsors and sponsored committees, so there is no basis for objecting to an

exception to contributions from sponsors to their sponsored committees. Such a provision is included in Attachment "D" as a new subdivision (f).

The other concerns expressed by Cal-LEAP, particularly the need for a "roadmap" explaining the interplay between regulations 18419 and 18428, require further study and input from other interested persons, and cannot be accommodated at this meeting.

Staff Recommendation

The emergency regulation adopted in December brings regulation 18428 into full conformity with the current version of § 85311. The regulation now indicates that aggregation rules governing contributions and independent expenditures are the same as the rules that define the reporting obligations of affiliated entities. If the Commission does not adopt this regulation now, the prior regulation will be revived by operation of law on April 25, resurrecting affiliation standards no longer sanctioned by the law. Attachment "A" is the "strikeout" draft presented to the Commission in December, illustrating the provisions that would come back into effect if the emergency regulation is not permanently adopted before April 25.

If the Commission approves regulation 18428 with modifications to the text of the emergency regulation (as shown on Attachment "D"), the previous amendments to regulation 18428 should be repealed and the emergency regulation should then be permanently adopted, as modified.

Attachments:

Emergency Regulation 18428 – Attachment "A"
Cal-LEAP Letter – Attachment "B"
Chart Illustrating Regulation 18428 – Attachment "C"
Regulation 18428, Adoption Version – Attachment "D"